Reporting the Statement of Cash Flows

Chapter 16

Wild and Shaw

Fundamental Accounting Principles

25th Edition

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Chapter 16 Learning Objectives

CONCEPTUAL

C1 Distinguish between operating, investing, and financing activities, and describe how noncash investing and financing activities are disclosed.

ANALYTICAL

A1 Analyze the statement of cash flows and apply the cash flow on total assets ratio.

PROCEDURAL

P1 Prepare a statement of cash flows.

P2 Compute cash flows from operating activities using the indirect method.

P3 Determine cash flows from both investing and financing activities.

P4 *Appendix 16A*—Illustrate use of a spreadsheet to prepare a statement of cash flows.

P5 *Appendix 16B*—Compute cash flows from operating activities using the direct method.

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Learning Objective C1

Distinguish between operating, investing, and financing activities, and describe how noncash investing and financing activities are disclosed.

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Purpose of the Statement of Cash Flows

How does a company receive its cash?

What explains the change in cash balance?

Why do income and cash flows differ?

Where does a company spend its cash?

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Importance of Cash Flows

Cash flows help:

- **users decide if a company has cash to pay its debts,**
- **users evaluate company's ability to pursue opportunities,**
- **managers plan day-to-day operations,**
- **managers make long-term investment decisions.**

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Measurement of Cash Flows

Cash flows includes both cash and cash equivalents

Cash equivalents must meet two criteria:

1. **be readily convertible into cash and**
2. **be sufficiently close to maturity so that market value is unaffected by interest rate changes.**

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Classification of Cash Flows

The Statement of Cash Flows includes the following three sections:

- **Operating Activities**
- **Investing Activities**
- **Financing Activities**

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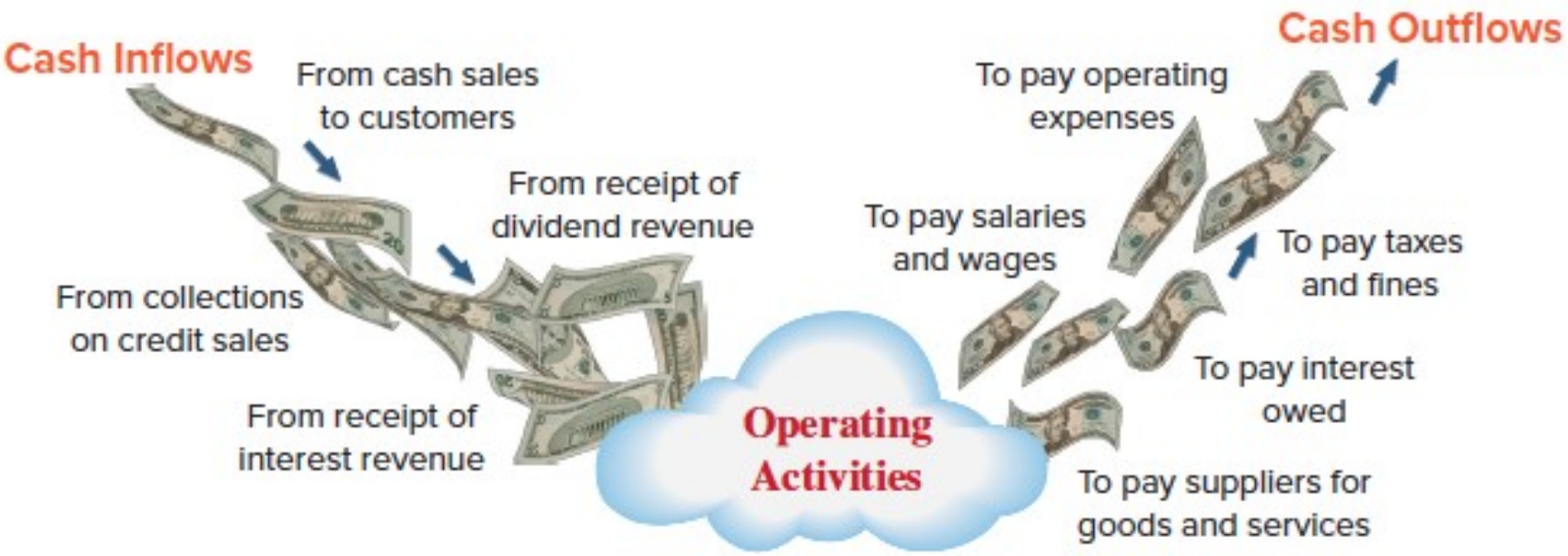
Operating Activities

Exhibit 16.1


Cash Inflows
From cash sales to customers
From receipt of dividend revenue
From collections on credit sales
From receipt of interest revenue
Operating Activities
Cash Outflows
To pay operating expenses
To pay salaries and wages
To pay taxes and fines
To pay interest owed
To pay suppliers for goods and services

Learning Objective C1: Distinguish between operating, investing, and financing activities, and describe how noncash investing and financing activities are disclosed.

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Investing Activities

Exhibit 16.2

Cash Inflows
From selling intangible assets
From selling plant assets
From collecting principal on notes receivable
From selling long-term investments
From selling short-term investments
From selling (discounting) notes receivable
Investing Activities
To buy intangible assets
To buy plant assets
Cash Outflows
To loan money in return for notes receivable
To buy short-term investments
To buy long-term investments

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Financing Activities

Exhibit 16.3

Cash Inflows
From issuing its common and preferred stock
From reissuing its treasury stock
From issuing its short- and long-term debt (notes payable and bonds payable)
From contributions by owners
Financing Activities
Cash Outflows
To pay dividends to shareholders
To purchase treasury stock
Withdrawals by owners
To pay off its short- and long-term debt (notes payable and bonds payable)

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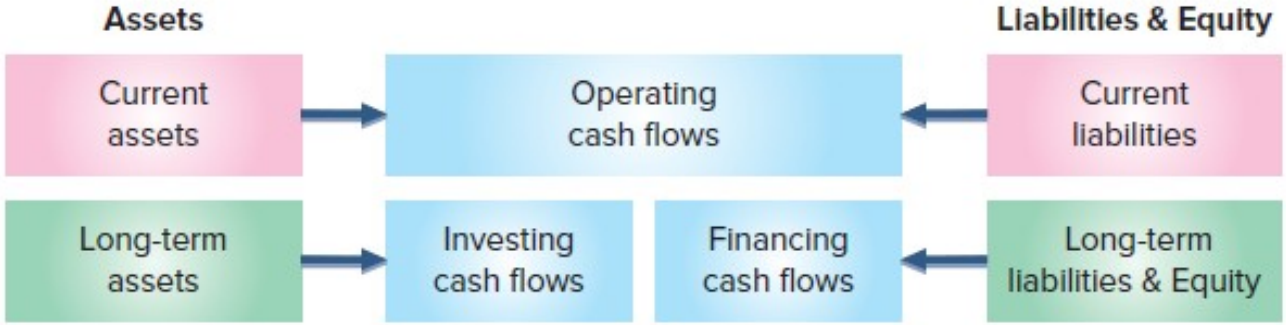
Link between Classification of Cash Flows and the Balance Sheet

- Operating, investing, and financing activities are loosely linked to the balance sheet.
- Operating activities are affected by changes in current assets and current liabilities.
- Investing activities are affected by changes in long-term assets.
- Financing activities are affected by changes in long-term liabilities and equity.

Exhibit 16.4



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Noncash Investing and Financing

Examples of Noncash Investing and Financing Activities:

Exhibit 16.5

- Retirement of debt by issuing equity stock.
- Conversion of preferred stock to common stock.
- Lease of assets in a long-term lease transaction.
- Purchase of long-term assets by issuing a note or bond.
- Exchange of noncash assets for other noncash assets.
- Purchase of noncash assets by issuing equity or debt.

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Learning Objective P1

Prepare a statement of cash flows.

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Format of the Statement of Cash Flows

Exhibit 16.6

COMPANY NAME Statement of Cash Flows For *period* Ended *date*	
Cash flows from operating activities	
[Compute operating cash flows using indirect or direct method]	
Net cash provided (used) by operating activities	$ #
Cash flows from investing activities	
[List of individual inflows and outflows]	
Net cash provided (used) by investing activities	#
Cash flows from financing activities	
[List of individual inflows and outflows]	
Net cash provided (used) by financing activities	#
Net increase (decrease) in cash	$ #
Cash (and equivalents) balance at prior period-end	#
Cash (and equivalents) balance at current period-end	$ #

Separate schedule or note disclosure of any noncash investing and financing transactions is required.

Learning Objective P1: Prepare a statement of cash flows.

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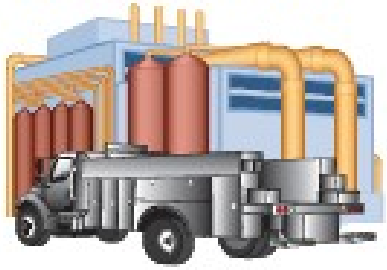
Preparing the Statement of Cash Flows

Exhibit 16.7

1 Compute net increase or decrease in cash.

2 Compute net cash from or for operating activities.

3 Compute net cash from or for investing activities.



4 Compute net cash from or for financing activities.

5 Compute net cash from all sources; then *prove* it by adding it to beginning cash to get ending cash.

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Analyzing the Cash Account

The Cash account is a natural place to look for information about cash flows from operating, investing, and financing activities.

Exhibit 16.8

Cash			
Balance, Dec. 31, 2020	12,000		
Receipts from customers	570,000	Payments for inventory	319,000
Receipts from asset sales	2,000	Payments for operating exp.	218,000
Receipts from stock issuance	15,000	Payments for interest	8,000
		Payments for taxes	5,000
		Payments for notes retirement	18,000
		Payments for dividends	14,000
Balance, Dec. 31, 2021	17,000		

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Analyzing Noncash Accounts

A second approach to preparing the statement of cash flows is analyzing noncash accounts.

Exhibit 16.9

Cash	=	Liabilities	+	Equity	–	Noncash assets

Learning Objective P1: Prepare a statement of cash flows.

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Information to Prepare the Statement

Information to prepare the statement of cash flows comes from three sources:

- Comparative Balance Sheets
- Current Income Statement
- Additional Information

Learning Objective P1: Prepare a statement of cash flows.

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Learning Objective P2

Compute cash flows from operating activities using the indirect method.

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Cash Flows from Operating

Indirect and Direct Methods of Reporting

Cash flows from operating activities		
Cash received from customers	$ 570,000	
Cash paid for merchandise	(319,000)	
Cash paid for wages and other operating expenses	(218,000)	
Cash paid for interest	(8,000)	
Cash paid for taxes	(5,000)	
Net cash provided by operating activities		$20,000

Direct Method

Indirect Method

Cash flows from operating activities		
Net income		$ 38,000
Adjustments to reconcile net income to net cash provided by operating activities		
Increase in accounts receivable	(20,000)	
Increase in merchandise inventory	(14,000)	
Increase in prepaid expenses	(2,000)	
Decrease in accounts payable	(5,000)	
Decrease in interest payable	(1,000)	
Increase in income taxes payable	10,000	
Depreciation expense	24,000	
Loss on sale of plant assets	6,000	
Gain on retirement of notes	(16,000)	
		0,00

The net cash amount provided by operating activities is identical under both the direct and indirect methods.

Learning Objective P1: Prepare a statement of cash flows.

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Cash Flows: Indirect Method Illustration

Exhibit 16.10

GENESIS Income Statement For Year Ended December 31, 2021		
Sales		$590,000
Cost of goods sold	$300,000	
Operating expenses (excluding depreciation)	216,000	
Depreciation expense	24,000	
Interest expense	7,000	(547,000)
		43,000
Other gains (losses)		
Loss on sale of plant assets	(6,000)	
Gain on retirement of notes	16,000	10,000
Income before taxes		53,000
Income taxes expense		
Net income		$ 38,000

Additional information for 2021

a. The accounts payable balances result from inventory purchases.

b. Purchased $60,000 in plant assets by issuing $60,000 of notes payable.

c. Sold plant assets with a book value of $8,000 (original cost of $20,000 and accumulated depreciation of $12,000) for $2,000 cash, yielding a $6,000 loss.

d. Received $15,000 cash from issuing 3,000 shares of common stock.

e. Paid $18,000 cash to retire notes with a $34,000 book value, yielding a $16,000 gain.

f. Declared and paid cash dividends of $14,000.

GENESIS Balance Sheets			
At December 31	**2021**	**2020**	**Change**
Assets			
Current assets			
Cash	$ 17,000	$ 12,000	**$ 5,000 Increase**
Accounts receivable	60,000	40,000	20,000 Increase
Inventory	84,000	70,000	14,000 Increase
Prepaid expenses	6,000	4,000	2,000 Increase
Total current assets	167,000	126,000	
Long-term assets			
Plant assets	2,50000	210,000	40,000 Increase
Accumulated depreciation	(60,000)	(48,000 0)	12,000 Increase
Total assets	$357,000	$288,000	
Liabilities			
Current liabilities			
Accounts payable	$ 35,000	$ 40,000	$ 5,000 Decrease
Interest payable	3,000	4,000	1,000 Decrease
Income taxes payable	22,000	12,000	10,000 Increase
Total current liabilities	60,000	56,000	
Long-term notes payable	90,000	64,000	26,000 Increase
Total liabilities	150,000	120,000	
Equity			
Common stock, $5 par	95,000	80,000	15,000

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Applying the Indirect Method

GENESIS
Statement of Cash Flows—Operating Section under Indirect Method
For Year Ended December 31, 2021

Cash flows from operating activities		
Net income	$ 38,000	
Adjustments to reconcile net income to net cash provided by operating activities		
(1) Income statement items not affecting cash		
Depreciation expense	24,000	
Loss on sale of plant assets	6,000	
Gain on retirement of notes	(16,000)	
(2) Changes in current assets and liabilities		
Increase in accounts receivable	(20,000)	
Increase in inventory	(14,000)	
Increase in prepaid expenses	(2,000)	
Decrease in accounts payable	(5,000)	
Decrease in interest payable	(1,000)	
Increase in income taxes payable	10,000	
Net cash provided by operating activities		**$20,000**

Exhibit 16.11

Learning Objective P2: Compute cash flows from operating activities using the indirect method.

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Adjustments for Income Statement Items Not Affecting Cash

- Expenses and losses with no cash outflows are added back to net income.
- Revenues and gains with no cash inflows are subtracted from net income.

Cash flows from operating activities		
	Net income	$ 38,000
	Adjustments to reconcile net income to net cash provided by operating activities	
	Income statement items not affecting cash	
1	Depreciation expense	24,000
1	Loss on sale of plant assets	6,000
1	Gain on retirement of notes	(16,000)

Learning Objective P2: Compute cash flows from operating activities using the indirect method.

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Adjustments for Changes in Current Assets and Current Liabilities: Table

	Change in Account Balance	
	Increase	Decrease
Current Assets	Subtract from net income	Add to net income
Current Liabilities	Add to net income	Subtract from net income

Use this table when adjusting Net Income to Operating Cash Flows.

Learning Objective P2: Compute cash flows from operating activities using the indirect method.

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Adjustments for Changes in Current Assets and Current Liabilities

- Decreases in current assets are added to net income.
- Increases in current assets are subtracted from net income.
- Increases in current liabilities are added to net income.
- Dec … d from

②	Changes in current assets and liabilities	
	Increase in accounts receivable	(20,000)
	Increase in inventory	(14,000)
	Increase in prepaid expenses	(2,000)
	Decrease in accounts payable	(5,000)
	Decrease in interest payable	(1,000)
	Increase in income taxes payable	10,000

Learning Objective P2: Compute cash flows from operating activities using the indirect method.

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Summary of Adjustments for Indirect Method: Part 2

Common adjustments to net income when computing net cash provided or used by operating activities under the indirect method:

Net Income (or Loss)

① Adjustments for operating items not providing or using cash

+ Noncash expenses and losses

Examples: Expenses for depreciation, depletion, and amortization; losses from disposal of long-term assets and from retirement of debt

– Noncash revenues and gains

Examples: Gains from disposal of long-term assets and from retirement of debt

② Adjustments for changes in current assets and current liabilities

+ Decrease in noncash current operating assets

– Increase in noncash current operating assets

+ Increase in current operating liabilities

– Decrease in current operating liabilities

Net cash provided (used) by operating activities

Exhibit 16.12

Learning Objective P2: Compute cash flows from operating activities using the indirect method.

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Learning Objective P3

Determine cash flows from both investing and financing activities.

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Cash Flows from Investing: Three-Step Analysis

A three-step process to determine cash provided or used by investing activities:

Identify changes in investing-related accounts

Determine the cash effects using T-accounts and reconstructed entries

Report the cash flow effects

Learning Objective P3: Determine cash flows from both investing and financing activities.

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Cash Flows from Investing: First Step

Exhibit 16.10

Assets			
Current assets			
Cash	$ 17,000	$ 12,000	**$ 5,000 Increase**
Accounts receivable	60,000	40,000	20,000 Increase
Inventory	84,000	70,000	14,000 Increase
Prepaid expenses	6,000	4,000	2,000 Increase
Total current assets	167,000	126,000	
Long-term assets			
Plant assets	2,50000	210,000	40,000 Increase
Accumulated depreciation	(60,000)	(48,0000)	12,000 Increase
Total assets	$357,000	$288,000	

This analysis reveals a $40,000 increase in plant assets from $210,000 to $250,000 and a $12,000 increase in accumulated depreciation from $48,000 to $60,000.

Learning Objective P3: Determine cash flows from both investing and financing activities.

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Cash Flows from Investing: Second Step

Item b: Genesis purchased plant assets of $60,000 by issuing $60,000 in notes payable to the seller.

Reconstruction	Plant Assets	60,000	
	Notes Payable		60,000

Item c reports that Genesis sold plant assets costing $20,000 (with $12,000 of accumulated depreciation) for $2,000 cash, resulting in a $6,000 loss.

Reconstruction	**Cash**	**2,000**	
	Accumulated Depreciation	12,000	
	Loss on Sale of Plant Assets	6,000	
	Plant Assets		20,000

We also reconstruct the entry for Depreciation Expense using information from the income statement.

Reconstruction	Depreciation Expense	24,000	
	Accumulated Depreciation		24,000

Learning C
activities.

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Cash Flows from Investing: Third Step

Reconstructed T-accounts show changes in long-term assets.

Plant Assets			
Bal., Dec. 31, 2020	210,000		
Purchase	**60,000**	**Sale**	**20,000**
Bal., Dec. 31, 2021	250,000		

Accumulated Depreciation—Plant			
		Bal., Dec. 31, 2020	48,000
Sale	**12,000**	**Depr. expense**	**24,000**
		Bal., Dec. 31, 2021	60,000

The identified cash flows are reported in the investing section:

Cash flows from investing activities	
Cash received from sale of plant assets	$2,000

The $60,000 purchase in item b paid using a note payable is a noncash investing and financing activity.

Noncash investing and financing activity	
Purchased plant assets with issuance of notes	$60,000

Learning Objective P
activities.

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Cash Flows from Financing: Three-Step Analysis

A three-step process to determine cash provided or used by financing activities:

Identify changes in financing-related accounts

Determine the cash effects using T-accounts and reconstructed entries

Report the cash flow effects

Learning Objective P3: Determine cash flows from both investing and financing activities.

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Cash Flows from Financing: First Step

Exhibit 16.10

Liabilities			
Current liabilities			
Accounts payable	$ 35,000	$ 40,000	$ 5,000 Decrease
Interest payable	3,000	4,000	1,000 Decrease
Income taxes payable	22,000	12,000	10,000 Increase
Total current liabilities	60,000	56,000	
Long-term notes payable	90,000	64,000	26,000 Increase
Total liabilities	150,000	120,000	

This analysis reveals: an increase in notes payable from $64,000 to $90,000.

Learning Objective P3: Determine cash flows from both investing and financing activities.

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Cash Flows from Financing: Second Step

Step two explains the change in item e. Notes with a carrying value of $34,000 are retired for $18,000 cash, resulting in a $16

Reconstruction	Notes Payable	34,000	
	Gain on retirement of debt		16,000
	Cash		18,000

Cash Flows from Financing: Third Step

Step three reports cash paid for the notes retirement in the financing activities section.

Notes Payable			
		Bal., Dec. 31, 2020	64,000
Retired notes	**34,000**	**Issued notes**	**60,000**

Cash flows from financing activities	
Cash paid to retire notes	$(18,000)

Learning Objective P
activities.

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Cash Flows from Financing: Common Stock Transactions

- **Step one** in analyzing stock reviews comparative balance sheets. Show an increase in common stock from $80,000 to $95,000.
- **Step two** explains change of item d which reports 3,000 shares of common stock are issued at par for $5 per share.
- **Step three** reports cash received from stock issuance in financing activities section.

Reconstruction

	Cash	**15,000**	
	Common Stock		15,000

Common Stock		
	Bal., Dec. 31, 2020	80,000
	Issued stock	**15,000**
	Bal., Dec. 31,	95,000

Cash flows from financing activities	
Cash received from issuing stock	$15,000

Learning Objective P
activities.

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Cash Flows from Financing: Retained Earnings Transactions

- **Step one** in analyzing Retained Earnings reviews comparative balance sheets. Show an increase in retained earnings from $88,000 to $112,000.
- **Step two** explains change of item f which reports cash dividends of $14,000 are paid.
- **Step three** reports cash paid for dividends in the financing a

Reconstruction

Retained Earnings 14,000

Cash **14,000**

Retained Earnings			
		Bal., Dec. 31, 2020	88,000
Cash dividend	**14,000**	**Net income**	**38,000**

Cash flows from financing activities	
Cash paid for dividends	$(14,000)

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activities.

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Proving Cash Balances

Exhibit 16.13

GENESIS Statement of Cash Flows (Indirect Method) For Year Ended December 31, 2021		
Cash flows from operating activities		
Net income	$ 38,000	
Adjustments to reconcile net income to net cash provided by operating activities		
Income statement items not affecting cash		
Depreciation expense	24,000	
Loss on sale of plant assets	6,000	
Gain on retirement of notes	(16,000)	
Changes in current assets and liabilities		
Increase in accounts receivable	(20,000)	
Increase in inventory	(14,000)	
Increase in prepaid expenses	(2,000)	
Decrease in accounts payable	(5,000)	
Decrease in interest payable	(1,000)	
Increase in income taxes payable	10,000	
Net cash provided by operating activities		$ 20,000
Cash flows from investing activities		
Cash received from sale of plant assets	2,000	
Net cash provided by investing activities		2,000
Cash flows from financing activities		
Cash received from issuing stock	15,000	
Cash paid to retire notes	(18,000)	
Cash paid for dividends	(14,000)	
Net cash used in financing activities		(17,000)
Net increase in cash		$ 5,000
Cash balance at prior year-end		12,000
Cash balance at current year-end		$ 17,000

Learning Objective P3: Determine cash flows from both investing and financing activities.

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Summary Using T-Accounts

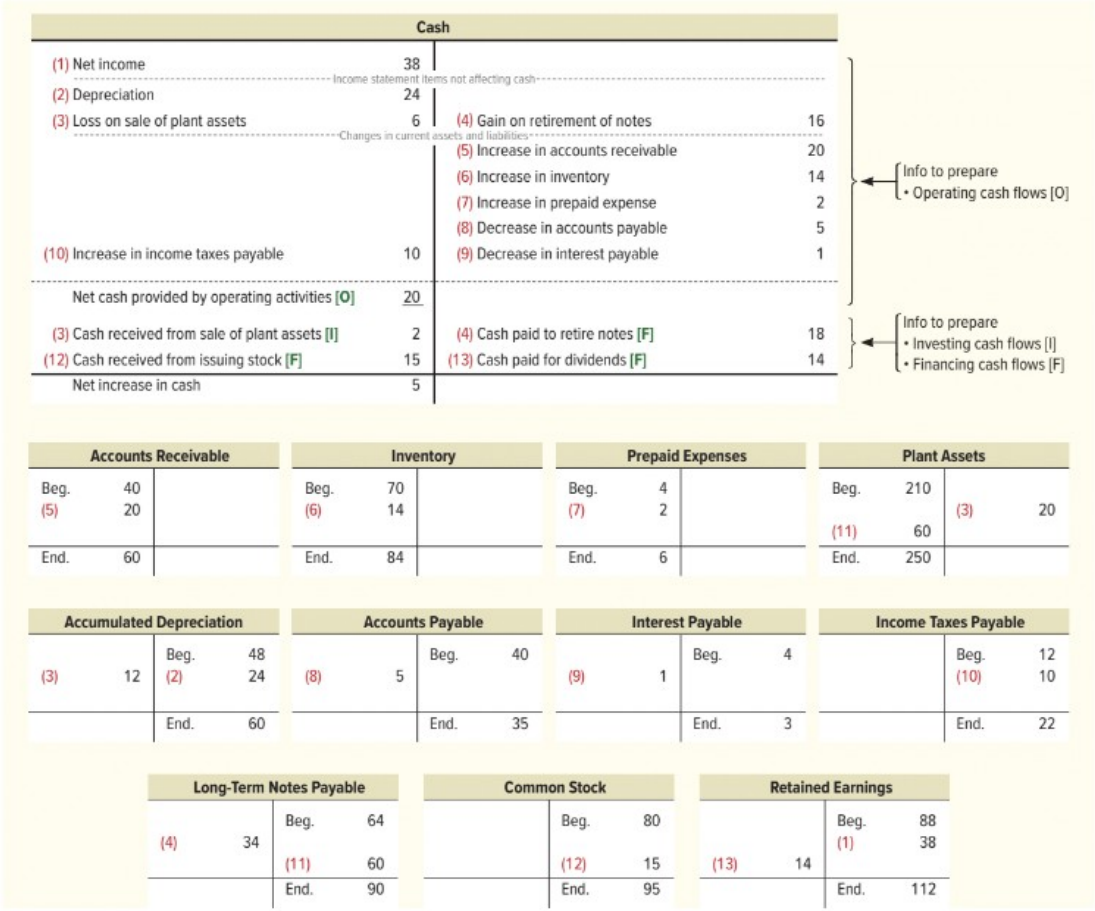

Exhibit 16.14

Learning Objective P3: Determine cash flows from both investing and financing activities.

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Learning Objective A1

Analyze the statement of cash flows and apply the cash flow on total assets ratio.

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Analyzing Cash Sources and Uses

- **Managers review cash flows for business decisions.**
- **Creditors evaluate a company's ability to generate enough cash to pay debt.**
- **Investors assess cash flows before buying**

$ thousands	BMX	ATV	Trex
Cash provided (used) by operating activities	$90,000	$40,000	$(24,000)
Cash provided (used) by investing activities			
Proceeds from sale of plant assets			26,000
Purchase of plant assets	(48,000)	(25,000)	
Cash provided (used) by financing activities			
Proceeds from issuance of debt			13,000
Repayment of debt	(27,000)		
Net increase (decrease) in cash	$15,000	$15,000	$ 15,000

Exhibit 16.15

Lea
tota

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Cash Flow on Total Assets

Used, along with income-based ratios, to assess company performance.

Exhibit 16.16

$$\text{Cash flow on total assets} = \frac{\text{Operating cash flows}}{\text{Average total assets}}$$

Learning Objective A1: Analyze the statement of cash flows and apply the cash flow on total assets ratio.

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Learning Objective P4

Appendix 16A
Illustrate use of a spreadsheet to prepare a statement of cash flows.

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Spreadsheet Preparation

GENESIS
Spreadsheet for Statement of Cash Flows—Indirect Method
For Year Ended December 31, 2021

	Dec. 31, 2020		Analysis of Changes Debit		Analysis of Changes Credit	Dec. 31, 2021
Balance Sheet—Debit Bal. Accounts						
Cash	$ 12,000					$ 17,000
Accounts receivable	40,000	(b)	$ 20,000			60,000
Inventory	70,000	(c)	14,000			84,000
Prepaid expenses	4,000	(d)	2,000			6,000
Plant assets	210,000	(k1)	60,000	(i)	$ 20,000	250,000
	$336,000					$417,000
Balance Sheet—Credit Bal. Accounts						
Accumulated depreciation	$ 48,000	(i)	12,000	(h)	24,000	$ 60,000
Accounts payable	40,000	(e)	5,000			35,000
Interest payable	4,000	(f)	1,000			3,000
Income taxes payable	12,000			(g)	10,000	22,000
Notes payable	64,000	(j)	34,000	(k2)	60,000	90,000
Common stock, $5 par value	80,000			(l)	15,000	95,000
Retained earnings	88,000	(m)	14,000	(a)	38,000	112,000
	$336,000					$417,000
Statement of Cash Flows						
Operating activities						
Net income		(a)	38,000			
Increase in accounts receivable				(b)	20,000	
Increase in inventory				(c)	14,000	
Increase in prepaid expenses				(d)	2,000	
Decrease in accounts payable				(e)	5,000	
Decrease in interest payable				(f)	1,000	
Increase in income taxes payable		(g)	10,000			
Depreciation expense		(h)	24,000			
Loss on sale of plant assets		(i)	6,000			
Gain on retirement of notes				(j)	16,000	
Investing activities						
Receipts from sale of plant assets		(i)	2,000			
Financing activities						
Payment to retire notes				(j)	18,000	
Receipts from issuing stock		(l)	15,000			
Payment of cash dividends				(m)	14,000	
Noncash Investing and Financing Activities						
Purchase of plant assets with notes		(k2)	60,000	(k1)	60,000	
			$317,000		$317,000	

Exhibit 16A.1

A spreadsheet, also called work sheet or working paper, can help us organize the information needed to prepare a statement of cash flows.

Learning Objective P4: Illustrate use of a spreadsheet to prepare a statement of cash flows.

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Learning Objective P5

Appendix 16B
Compute cash flows from operating activities using the direct method.

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Direct Method of Reporting Operating Cash Flows: Operating Activities

Adjust income statement accounts related to operating activities for changes in their related balance sheet accounts:

Revenue or expense	+ or −	Adjustments for changes in related balance sheet accounts	=	Cash receipts or cash payments

Exhibit 16B.1

Framework for reporting cash receipts and cash payments

Learning Objective P5: Compute cash flows from operating activities using the direct method.

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Direct Method of Reporting Operating Cash Flows

Exhibit 16B.6

Item	From Income Statement	Adjustments to Obtain Cash Flow Numbers
Receipts		
From sales	Sales Revenue	+ Decrease in Accounts Receivable – Increase in Accounts Receivable
From rent	Rent Revenue	+ Decrease in Rent Receivable – Increase in Rent Receivable
From interest	Interest Revenue	+ Decrease in Interest Receivable – Increase in Interest Receivable
From dividends	Dividend Revenue	+ Decrease in Dividends Receivable – Increase in Dividends Receivable
Payments		
To suppliers	Cost of Goods Sold	+ Increase in Inventory – Decrease in Inventory + Decrease in Accounts Payable – Increase in Accounts Payable
For operations	Operating Expense	+ Increase in Prepaids – Decrease in Prepaids + Decrease in Accrued Liabilities – Increase in Accrued Liabilities
To employees	Wages (Salaries) Expense	+ Decrease in Wages (Salaries) Payable – Increase in Wages (Salaries) Payable
For interest	Interest Expense	+ Decrease in Interest Payable – Increase in Interest Payable
For taxes	Income Tax Expense	+ Decrease in Income Tax Payable – Increase in Income Tax Payable

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End of Chapter 16

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